

Economic Trends

Alberta's expansion downshifting

The impact of lower oil prices on Alberta's economy is starting to feed through to most of the major economic indicators. Interprovincial migration is showing signs of slowing alongside the labour market. Although housing starts have been solid so far this year, the resale market has cooled. The value of exports and manufacturing shipments fell in January on lower prices, and rig activity pulled back considerably in the first quarter of this year. This month's *inFocus* provides a brief summary of Budget 2015's *Economic Outlook*.

Alberta Household Sector

Migration slows

Alberta's population grew 2.5% year-over-year (y/y) in the fourth quarter of 2014, leading all the provinces. Despite the gain, growth is showing signs of slowing. Interprovincial migration, a strong source of growth over the past four years, posted the lowest quarterly gain (+4,178) since the third quarter of 2011. Although the province settled a fourth quarter record 9,180 new permanent residents, net international migration was

pulled down by a large net outflow of non-permanent residents (NPRs). This drop was not unexpected, since the net number of NPRs tends to be smaller in the last quarter of the year. However, this quarter's drop was particularly pronounced, likely related to recent changes to the Temporary Foreign Worker program.

Employment feeling the pinch

The labour market is feeling the pressure of declining activity in the province. February employment losses

of 14,000 wiped out the job gains in January, returning employment to just below December 2014 levels. At the industry level, employment in the natural resources industry has declined since mid-2014, and shed 8,000 jobs in the first two months of 2015. Similarly, the professional and scientific services industry lost over 10,000 in January and February. Earnings growth in the natural resources industry slowed considerably in the last quarter of 2014.

Confidence hits resale market

Alberta's housing market is on two different paths: new housing activity remains strong, but the resale market has softened (Chart 1). Alberta's sales-to-new listings ratio fell dramatically between December and February. This was the result of a jump in new listings and a decline in sales, mainly in Calgary. Prices were down 3.3% year-to-date in February, the first time in two years. In contrast, momentum pushed housing starts to 44,400 SAAR in January and February, 19.3% higher than first two months of last year. Edmonton led the gain, posting record high annualized starts, while starts in Calgary fell to their lowest level in almost 4 years.

Indicator	Latest Month	Value	Change year-over-year (y/y)
Employment (thousands)	February	2,300	+1.6%
Unemployment Rate	February	5.3%	+0.9 p.p.
CPI Inflation (unadjusted)	February	0.9%	-1.5 p.p.
Retail Sales	January	\$6.3 B	-2.3%
Housing Starts (annualized)	February	44,400	+25.5%
Rigs Drilling (unadjusted)	March	99	+64.8%
Manufacturing Shipments	January	\$5.9 B	-8.5%
Exports (unadjusted)	January	\$9.0 B	-16.0%

Source: Statistics Canada, CAODC, CMHC. p.p.= percentage points.

Chart 1: Alberta existing and new housing markets diverge
Annualized Existing Home Sales & Housing Starts, 3-month moving average



Sources: Canadian Real Estate Association and Canadian Mortgage and Housing Corp.

Inflation softening

After remaining elevated for most of 2014, consumer price pressures eased considerably to start 2015. Inflation fell below 1% in January and February, mainly on declining energy prices. Gasoline prices fell almost 23% y/y in February, while natural gas (-17% y/y) and electricity (-4.6% y/y) prices were also down. Despite moderating consumer prices, retail sales retreated in January. They were down 2.3% y/y, the first year-over-year drop in five years. Sales took a hit from falling gasoline prices, and were also dragged down by declining motor vehicle sales. Most of the other retail sales categories posted moderate growth.

Alberta Business Sector

Pull back in rigs drilling

With falling oil prices, producers no longer see the returns to justify additional exploration. As a result, rig activity has plummeted across North America. March active rigs in Alberta fell by 65% y/y to 99. Canada's rig count was 165, while the United States rig count was 1109, a decrease of 39% y/y. The rig utilization rate in Alberta dropped to 19%, just slightly higher than the all-time March low of 18% in 2009.

Oil prices pull down export values

Export volumes remained fairly steady in January, but the value of Alberta's

exports declined significantly on lower energy prices. This was the first year-over-year decline since June 2013. Exports fell 16% y/y, mainly because of a 24% decline in energy exports. Non-energy exports continued to post impressive gains. In January, they were up 13% y/y, led by consumer goods, industrial machinery and equipment, and plastics and industrial chemicals.

Non-energy shipments strong

Shipments of manufactured goods were down in January 2015 year-over-year for the first time almost 2 years, falling 8.5%. Petroleum and coal products were the culprit, falling 42% on lower prices and volumes. Excluding energy products, however, shipments remained solid, gaining 5.5% y/y. Food manufacturing posted strong growth of almost 12% y/y, supported by strong beef prices and an increase in meat slaughtering. Durable goods, including wood products and machinery, also posted a solid gain of 9.9% y/y.

Building permits soften

The value of building permits issued by Alberta municipalities in January fell to \$1.3 billion, a 10-month low. Building permits have been drifting lower since June 2014, as residential permits have flattened out and non-residential permits have declined. Commercial permits were down around 16% y/y

in January, falling to the lowest level in almost two years. Commercial permits represent about two-thirds of non-residential permits. Much of the slowdown in permit issuance since June has been centred on the Calgary region, where permits fell under \$400 million for the first time in two years, down one-third year-over-year.

Outside Alberta

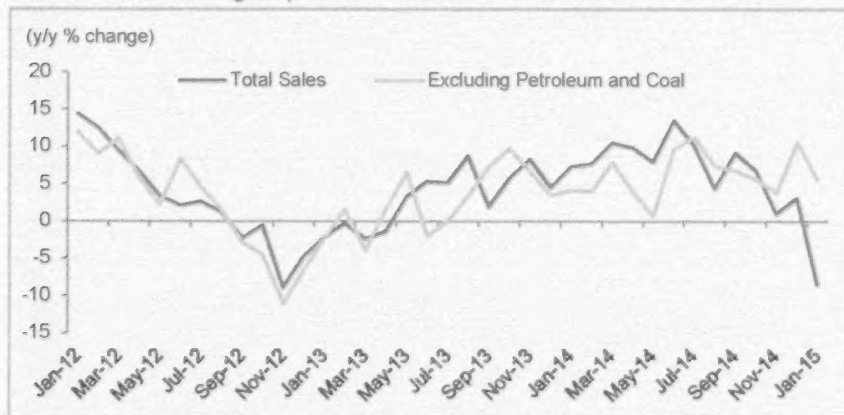
Fed adjusts forward guidance

The US Federal Reserve (the Fed) held its target interest rate at 0%-0.25%, but changed the time-linked "forward guidance" from the policy announcement. Instead of being "patient" about future interest rate hikes, the Fed indicated that it will assess conditions on a meeting-by-meeting basis. The Fed noted that inflationary pressures remain weak and expressed some caution about the US economic outlook, partly a result of the stronger US dollar. The removal of forward guidance was viewed as a signal of impending, but gradual, withdrawal of monetary stimulus. The Fed hasn't changed its target interest since December 2008.

Greece weighs on EU prospect

The outlook for the EU has improved modestly, but Greece's continuing financial woes remain a significant challenge to growth. Earlier in the year, the European Central Bank (ECB) and other creditors agreed to provide an additional €3.3 billion as a part of Greece's bailout. Negotiations over the bailout's extension are ongoing. If a new agreement is not reached, Greece will face insolvency. Greece's sovereign bonds could be degraded, curtailing public and private sector access to credit. Greece remains economically distressed as negotiations continue over economic reforms and the inclusion of Greek bonds in the ECB's Quantitative Easing program.

Chart 2: Non-petroleum manufacturing holds up
Alberta Manufacturing Shipments



Sources: Statistics Canada

Contact

Erin Bartmanovich

780.427.8814

inFocus

Low oil prices slow Alberta's Economy

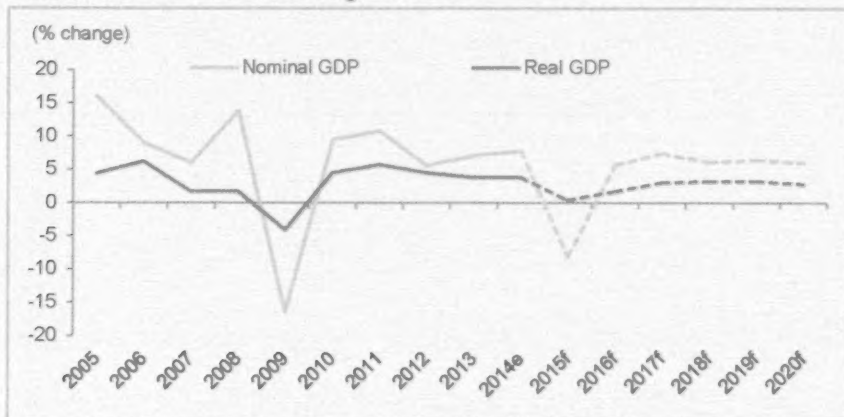
This InFocus summarizes the *Alberta Budget 2015 Economic Outlook*

Alberta's economic expansion will pause in 2015 after five years of exceptional growth. Weaker oil prices will dampen economic activity as energy companies pull back on investment and cut costs. Alberta's labour market is expected to cool significantly in 2015, weighing on interprovincial migration.

Real GDP is forecast to grow a mere 0.4% in 2015, well below the average annual increase of over 4% since 2010. This weakness will carry into 2016, with growth edging up to 1.7% before normalizing at around 3% in 2017 as oil prices recover.

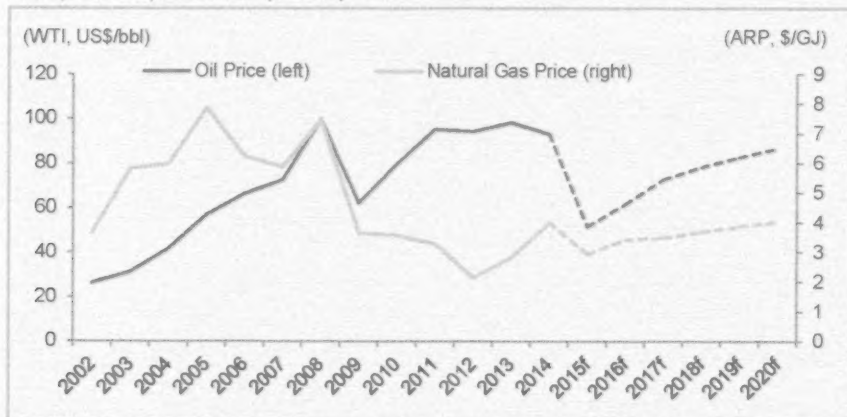
Chart 1: Real GDP growth to slow as nominal GDP declines

Alberta Real and Nominal GDP growth



Source: Statistics Canada and Alberta Treasury Board and Finance

Chart 2: Oil price outlook deteriorates and gas prices remain flat
WTI (\$US/bbl) and ARP (\$/GJ)



Source: Alberta Energy

The most significant impact of lower oil prices will be on incomes. Nominal GDP, a broad measure of income, is forecast to decline more than 8% in 2015, then gradually improve with energy prices. Corporate profits and Government of Alberta revenue will be hit hard, falling well below 2014 levels.

With energy investment declining, trade will drive Alberta's economy in 2015 and 2016. Export volumes will increase, lifted by rising oil sands production while imports will decline due to the pullback in investment. A stronger US economy and weaker Canadian dollar will support many non-energy industries. All industries will benefit from weaker cost pressures as the economy performs below its potential over the next two years. Households will add to growth as the population expands and consumers increase spending, but at a much slower pace.

Oil price outlook deteriorates

Strong crude supply growth and lower-than-forecast global oil demand led to an oil market correction in late 2014. OPEC's November decision to not cut production pushed oil prices down further. WTI is forecast at around US\$55/bbl in 2015-16, gradually rising to nearly US\$84/bbl by 2019-20 as excess supplies are removed from the market (Chart 2). For Alberta producers, a narrower light-heavy differential has partially offset lower world oil prices. The WTI-WCS differential narrowed to US\$17/bbl in 2014-15 reflecting strong heavy oil demand, pipeline expansions and crude-by-rail investments. It is expected to widen again to around US\$23/bbl by 2017-18 due to constraints in the pipeline network.

Energy investment to contract and oil production to expand

Conventional oil investment, with its short lifespan and sensitivity to prices, is expected to fall by about 40% in 2015. The impact on oil sands investment will be less pronounced. Oil sands projects are capital intensive, take several years to construct and have long production life cycles. Overall, energy investment is expected to fall by around 30% in 2015 and 5% in 2016, then post moderate growth through the forecast period. Net corporate operating surplus, a measure of corporate profits, is expected to fall 50% in 2015, not returning to 2014 levels until 2018.

While conventional oil production will be impacted by lower prices in 2015, oil sands production will continue to expand. Projects nearing completion are expected to add over 500,000 barrels per day of production in the next three years. Those already operating are not expected to shut-in production, as per barrel operating costs are below expected prices. If prices fall below forecast levels, some production may be at risk, particularly in 2019 and 2020.

Non-energy production on the rise

Other Alberta industries, such as forestry, agriculture and manufacturing, will continue to boost output over the forecast period, bolstered by a lower Canadian dollar, easing cost pressures and a stronger US economy.

In the manufacturing sector, the plastic and chemical industry has sustained strong levels of investment, raising capacity and exports. The slowdown in oil and gas activity in both the US and Canada will lead to a drop in demand for Alberta's oil-related machinery and fabricated metal, which have surged in recent years. As a result, growth in manufacturing exports will slow by over half in 2015, before picking-up over the medium term to just over 3% annually.

In agriculture, cattle producers will continue to benefit from higher prices, as the cattle stock in North America has fallen to a near multi-decade low. On the other hand, cash receipts for crop producers eased in 2014 on lower prices for wheat and canola. Prices should improve slightly in 2015, with crop exports expected to remain near 2014 levels.

Interprovincial migration slows

The province is forecast to add 14,500 residents from other provinces in the 2015 census year (ending July 1) and 7,000 in 2016, compared with 38,700 in 2014.

Chart 3: The labour market is expected to cool

Alberta Monthly and Annual Average Employment Level and Growth



Source: Statistics Canada Alberta Treasury Board and Finance

Despite the slowdown, 2% population growth is expected this year and 1.7% in 2016, before picking up slightly over the medium term. Immigration, which is slower to react to economic changes, will be an important source of growth.

Labour market cooling

The average level of employment is forecast to be only 0.6% higher than in 2014. Strong job growth in late 2014 provided momentum heading into 2015, but lower oil prices are starting to have an impact. In February, the province lost 14,000 jobs, erasing January's gain. Employment is expected to fall further for the remainder of the year (Chart 3). The unemployment rate is expected to increase to 5.9% by 2016. Weakness in the labour market will persist through 2016 before improving as activity in the province picks up, with employment growth moving closer to 2% by 2017.

A weaker labour market will translate into softer earnings growth. Growth in household income, a key driver of personal income tax revenue, is forecast to slow by more than half to 2.4% in 2015 and 3.5% in 2016.

A soft landing is expected for Alberta's housing market. Resale activity has declined and prices have softened, however, low home inventories, a tight rental market and low interest rates will help buoy demand for housing. Housing starts are forecast to drop by 17% to 33,600 in 2015, falling further to 30,500 in 2016.

Growth to recover

A contraction in real economic activity is not expected this year. Contributions from trade and consumer spending are forecast to offset the effects of sharply lower energy investment. Growth will remain weak at 1.7% in 2016 before moving closer to the historical trend of around 3% over the medium term, as oil prices recover.

Contact

Catherine Rothrock 780.427.2758